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CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 8.

NATIONAL SURETY COMPANY, *et al.*,
Petitioners
(Appellants Below),

vs.

VALERIA E. CORIELL,
Respondent
(Appellee Below),

MORRIS WHITE, INC.,
Respondent
(Appellee Below),

IRVING TRUST COMPANY, as Receiver of Morris White, Inc.,
Respondent
(Appellee Below),

MICHAEL HOLLANDER, *et al.*, Constituting a Committee of Creditors of Morris White, Inc.,
Respondent
(Appellee Below).

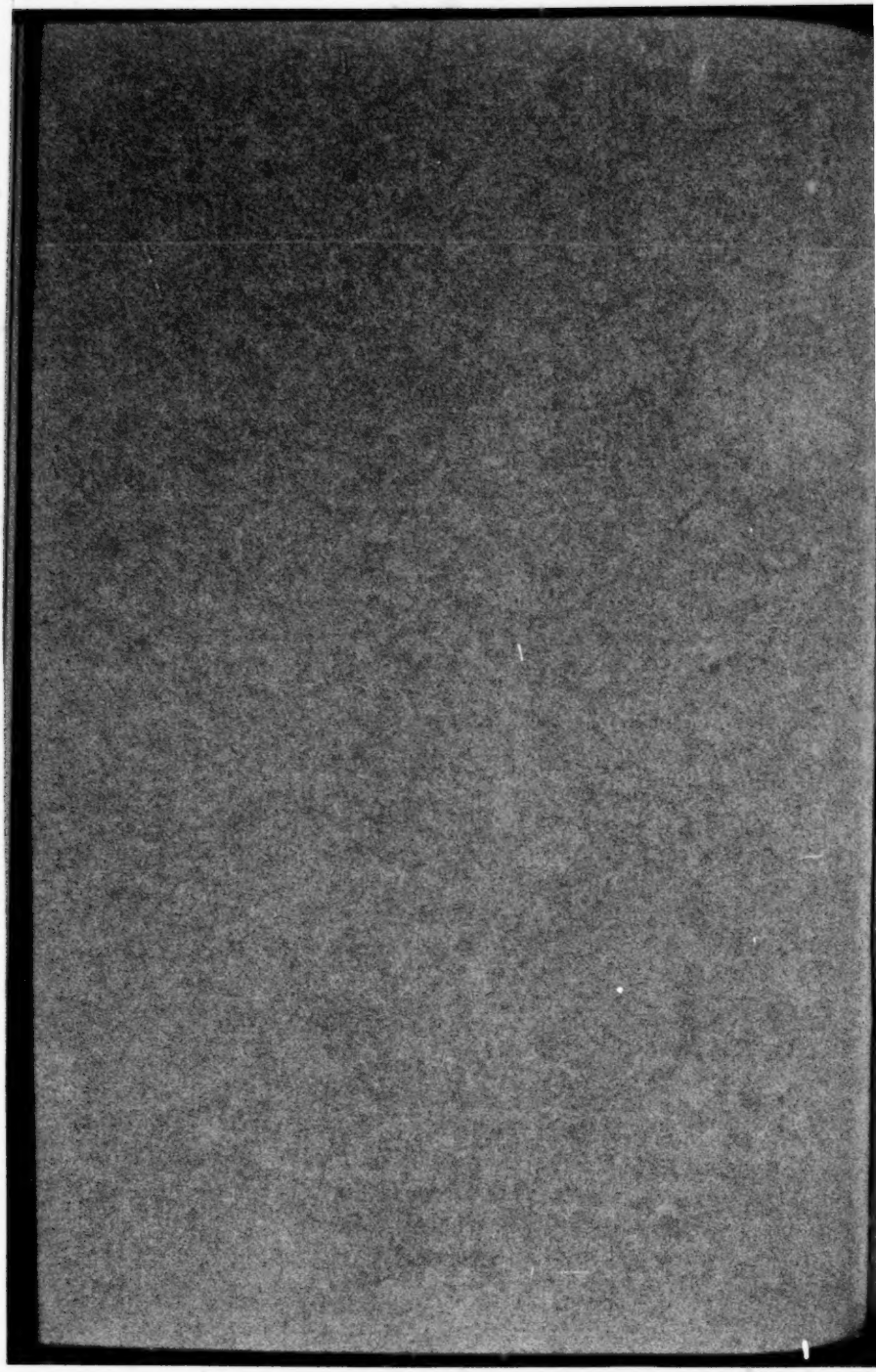
BRIEF FOR PETITIONERS ON WRIT OF CERTIORARI TO REVIEW ORDER OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, DATED NOVEMBER 25, 1931.

CHARLES H. TUTTLE,
of New York,

GREGORY HANKIN,
of Washington,

SAUL S. MYERS,
of New York,

Counsel for Petitioners.



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MICHAEL HOLLANDER, et al., Constituting a Committee of Creditors of MORRIS WHITE, INC.,
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BRIEF FOR PETITIONERS.

This case comes before the Court on a writ of certiorari to the Circuit Court of Appeals for the Second Circuit, issued May 16, 1932 (286 U. S. 537).

Opinions Below.

The order of the District Court forming the basis of the appeal to the Circuit Court of Appeals is printed on pages 151 to 155 of the Record. No written opinion was filed by the District Court, but it orally stated its views (R., 130-132). The opinion of the Circuit Court of Appeals (R., 165-174) is reported in 54 F. (2d) 255.

Statement of Facts.

Mr. Morris White.

On December 11, 1930 the Superintendent of Banks of the State of New York closed the doors of the Bank of United States. Morris White was a director and owned 4,000 or 5,000 of its shares (R., 120). To use his own words, he was "connected in some of the deals there and I was cleaned" (R., 120).

At the time of the bank's closing, Morris White was in the business of manufacturing handbags under the name of Morris White, Inc. (R., 86, 120). As he testified: "Morris White, Inc. is Morris White" (R., 123). While that business had been profitable, he had lost money in the stock market (R., 120, 67), and had allegedly lost $20,000,000 in outside ventures (R., 86, 131). At the time when this suit was begun, he was "dead broke", as a result apparently of what his counsel called "his over-expansion in outside interests" (R., 91), and was "not worth anything" (R., 86).

In the District Court he admitted that he personally owed Morris White, Inc. $137,729.68, representing money taken by him from it and employed in his other ventures (R., 121, 122); and that the Morris White Holding Co., Inc., which was the corporate form through which he conducted his real estate speculations owed the Morris White, Inc. over $1,700,000, likewise representing money diverted by him from it to the Holding Company (R., 122, 123). These huge sums represented in the aggregate nearly double the entire indebtedness of the Morris White, Inc. (R., 134, 135); and its insolvency was due principally to these enor-

mous diversions by White. The Morris White Holding Co. Inc. went into bankruptcy in April, 1931 (R., 78; 52 F. (2d) 499).

The Institution of the "friendly" Equity Receivership.

About the time the Bank of United States closed, White's bank creditors took possession of Morris White, Inc. under what they called an informal "friendly receivership" which lasted until April 6, 1931 (R., 74, 107, 121).

During that period the banks, under a promise to continue to finance Morris White, Inc. (R., 75, 99), had their claims paid down and took receivables as security (R., 173, 19, 49, 50, 53, 121). The receivables thus assigned reached the huge sum of $251,409.42 to secure loans of $179,116.81 (R., 134).

During this informal "friendly receivership" $750,000 was paid to certain creditors apparently in preference to other creditors (R., 74, 75), so that on April 6, 1931, there remained in the treasury of Morris White, Inc. only $5,614.60 in cash (R., 134). What creditors received that money and what other preferences sprang out of that "friendly receivership" has not thus far been adequately inquired into.

However, this "friendly" manipulation came to an end when Pfister & Vogel Leather Company, a creditor, "refused to play along" (R., 74, 75), secured a judgment for $25,036.26, issued execution on March 31, 1931 (R., 35) and found no funds (R., 41).

Instead, however, of invalidating the lien and preference of this judgment by putting the Morris White, Inc. into bankruptcy, White and the creditors conducting the informal "friendly receivership", resolved to secure a formal "friendly receivership" at the price of paying the judgment in full (R., 34). Some results would be that the preferences and priorities established during the preceding four months would not be automatically invalidated; the $750,000 paid to certain creditors during that period would not be in jeopardy of recovery for all the creditors; an effective inquiry under Sec. 21-A of the Bankruptcy Act

would be escaped; White's diversions of over $2,000,000 would avoid the harsh scrutiny of the Bankruptcy Court; and the assets of the Morris White, Inc. would (so it was supposed and planned) be readily and safely juggled over to a new White company without giving the non-assenting creditors anything but paper.

Accordingly the so-called "creditors' committee" which had been conducting the informal "friendly receivership" and which contained two representatives of the banks and three representatives of certain merchandise creditors, "planned an equity receivership" (R., 57, 75). One of the banks assigned to a convenient non-resident dummy, without value or consideration, a note of the defendant corporation for $45,000 on which there was due $27,900 (R., 4). That dummy thereupon filed, on April 6, 1931, the present bill of complaint, by Olcott, Holmes, Glass, Paul & Havens as solicitors, with Joseph Glass of that firm as counsel (R., 7). On the same day, Morris White, Inc. filed an assenting answer, and the Irving Trust Company was appointed equity receiver (R., 8). The receiver immediately retained the complainant's solicitors and counsel as its solicitors and counsel, and they have *ever since* been acting as such *both for the complainant and for the receiver* (R., 47, 165). In other words, since their client, the dummy complainant, is obviously the mere nominee of the said "creditors' committee", it must fairly be assumed that these solicitors and counsel were the choice of that committee when it "planned an equity receivership" (R., 57, 75), and that in continuing to represent the complainant they are continuing to represent the interests for whom she is a dummy.

The Bill of Complaint.

The dummy complainant was at most a simple contract creditor, without judgment or collateral.

The complaint alleged that "the business of the defendant and its subsidiary corporations has been conducted successfully and prosperously since 1926, and was a growing

and profitable business up to about a year ago" since which time "a very substantial part of defendant's assets has become tied up in its inventories" (R., 2); that the assets of the defendant Morris White, Inc. exceeded its liabilities by $3,000,000 (R., 2); that the liabilities, however, were "in excess of its quick assets available for payment of same" (R., 2); that "the large majority of the creditors of defendant in number and amount expressed their willingness to extend the time of payment of the indebtedness" (R., 2); but that one of the creditors obtained a judgment against Morris White, Inc. in the sum of approximately $25,000 (R., 2); that other creditors were pressing their claims; that unless a receiver were at once appointed Morris White, Inc. would be subjected to a multiplicity of suits, its assets would be dissipated, some creditors would secure preferences over others and the defendant's business would be destroyed (R., 3).

The complaint then went on to point out that at a forced sale the value of the defendant's assets would be greatly impaired, and that if the properties of the defendant could be preserved and administered by a court of equity and the business of the defendant continued by a receiver, the value of the assets would be maintained and the rights of the creditors protected (R., 4).

Such was the avowed purpose of the receivership. But the real purpose of Morris White and his associates (as we believe this record abundantly shows) was (a) to carry out a scheme, with the sanction of the equity court, whereby, without putting Morris White, Inc. into bankruptcy, Morris White might retain the assets of that corporation and pay its creditors in paper; (b) to prevent an examination of preceding preferential payments and arrangements (R., 74, 75); and (c) to exempt Morris White and his associates and the books of his various corporate enterprises from a searching examination in bankruptcy.

Certain of the allegations in the complaint were shockingly untrue and uncandid and must, we submit, have been known by Morris White to be such at the time that he signed

and swore to the answer by which all of the allegations of the complaint were admitted (R., 8).

Thus, it was not disclosed in the complaint that the defendant had only about $5,000 in cash (R., 134); or that it owed for federal and state taxes over $158,000 (R., 101); or that, among the book "assets" alleged to be "in excess of $4,000,000" (R., 2), there were included claims for $2,777,714.89 (R., 134) against White's other companies, principally the aforesaid claim for $137,729.68 against himself (who is now admitted to have been "dead broke", R., 86, 91, 121-2), and the aforesaid claim for over $1,700,000 against Morris White Holding Co., Inc. (which even then was going into bankruptcy, R., 78, 52 F. (2d) 499).

While the bill of complaint stated that "the books" showed assets in excess of $4,000,000, it did not state what was their actual value. As a matter of fact, the actual value was tremendously less,—as those promoting the equity receivership must have known. Thus, Mr. Glass, counsel for the complainant and the receiver, told the District Court in May, 1931, that whereas the merchandise on the books as of April 6, 1931, had a book value of $1,249,000, nevertheless it "was estimated to realize $357,000 on receiver's sales in liquidation and $717,000 on a going concern basis" (R., 62).

The Offer of Mrs. Morris White, and the So-called Reorganization Plan.

Although the professed purpose of the complaint was to carry on the business and pay the creditors in full (R., 3, 4, 77), nevertheless three weeks later, to wit, on April 29, 1931, an offer was made by Mrs. Morris White to "purchase" all of the assets of Morris White, Inc. (R., 18-32).

That offer, in its terms and effect, is rather neatly summarized in the District Court's observation that thereby Morris White has "got the capital of the creditors there for years at his disposal" (R., 89), and in the following

colloquy between the Court and counsel for Morris White, Inc. (R., 96):

> "The Court: Yes; you (White) are taking all the assets of the creditors and wiping them out, with the exception of 20 per cent of their claims and subjecting them to the hazards of the enterprise. Now, most reorganization schemes, either by way of composition or otherwise, provide for the payment of some cash to the creditors so that they get something out of it; and where the whole thing is being taken——
>
> Mr. Stern: That is impossible, in this situation."

The offer made no provision at all for any payment of cash to any creditor or for putting any cash or any new capital or new personnel into the business (R., 26, 50, 55, 66, 139). It made no provision for the payment of any money whatever to any dissenting creditor (R., 26). It proposed that the Court by mere *fiat* should wipe out the creditors (except for 20 per cent. of the indebtedness to them), and compel them all (whether willing or unwilling) to give over their capital to a new corporation under the management and control of Morris White, and, without any security, to take the gamble as to what he might do with it.

Mrs. Morris White's offer was for all the interest of Morris White, Inc. and of the receiver in the assets, business and properties of Morris White, Inc. It provided that the offerer would organize a New York corporation under the name of Morris White Handbags Corp. with an authorized capital of 10,000 shares, of which 1,000 shares were to be common without par value and to be issued for such consideration as the board of directors might deem advisable. The remaining 9,000 shares were preferred stock, of the par value of $100 per share, to be issued by the new corporation in extinguishment of 80% of the proven and allowed indebtedness to the creditors. In other words, Morris White was to have the common stock, and the creditors the preferred stock (or rather, as shown hereafter, voting trust certificates for the same).

Under this plan, the secured creditors are enabled, notwithstanding their security, to receive stock and notes for their entire claims. According to the admissions of the respondents, the banks are secured by assigned accounts receivable for about 60% of their claims (R., 173, 19, 49, 50, 53, 121, 134),—the accounts receivable so assigned being about 82% of the entire receivables (R., 90, 91, 134). Nevertheless, the White offer enables the banks to receive notes for 20% of their entire claims. Thus the banks are put in position to collect 80% of their claims whereas the unsecured creditors would at the best get only 20%.

The control of the corporation was to be in the common stock, to wit: Morris White (R., 54). To quote the offer (R., 21):

> "Except as otherwise provided by statute, and except as is expressly provided herein, the holders of the common capital stock shall have the sole and exclusive right to vote and consent for any purpose and the holders of the preferred stock shall have only such voice or vote in regard to the management of the corporation as is expressly herein granted and all other powers, express or implied, shall be held and had by the owners and holders of the common stock."

As if this all-inclusive grant of control were not sufficient, the offer expressly specified certain subjects as to which the preferred stock should not be entitled to vote (R., 56). These subjects were (R., 21, 22):

1. Increase or decrease of the common capital stock of the corporation.
2. Any proceeding for the mortgaging of the property of the new company.
3. Any proceeding for the sale of the property of the new company.
4. Any change of name.
5. The matter of voluntary dissolution.

Even the right given to the preferred stockholders in the early part of the offer "to elect two of the five directors" (R., 22, 54), was qualified in the latter part of the offer by the provision that the preferred stock should actually be put in the names of two voting trustees for a period of ten years,—one of such trustees to be designated by the members of the Creditors' Committee representing the merchandise creditors and the other to be designated by the members of the Creditors' Committee representing the bank creditors (R., 28, 85).

The voting trustees were thereupon, year by year, to elect to the board of directors, "one member of the Creditors' Committee representing the merchandise creditors" and "one member of the Creditors' Committee representing the bank creditors" (R., 29, 69).

In other words and in reality, the majority of the board of directors were to be nominated and controlled by Morris White (R., 94, 69, 113), and the minority were not even to represent the creditors *but only the Creditors' Committee,* which committee, according to its own claims, did not represent more than $589,000 out of the total indebtedness (R., 17). Counsel for Morris White, Inc. admitted that nearly $300,000 of this amount was represented by the banks (R., 57); and counsel for the Creditors' Committee stated that the Committee represented $178,000 of merchandise creditors and $262,500 of bank creditors and that the balance of the representation on the Creditors' Committee was made up of secured indebtedness (R., 72).

The offer further provided that of the three directors to be voted for by the common stock (R., 22), Morris White would be one, and that he would also be president of the new corporation (R., 22).

The preferred stock was to receive from the net profits of the corporation "as and when declared by the board of directors" non-cumulative dividends at six per cent. annually (R., 23). In the event an audit for any fiscal year

showed that there had been net operating profits earned, the board of directors was required to apply one-third thereof in the redemption or retirement of the preferred stock (R., 24). Under these provisions, the board could annually build up a reserve of nearly two-thirds of the profits for the common stock, to wit, for Morris White.

The common stock was not to be paid dividends until the preferred stock had been retired (R., 23).

The board of directors were given the exclusive right to employ the executives of the new corporation and to fix the salaries thereof; but as long as any of the notes mentioned in the offer were unpaid, such action required the concurrent vote of four of the five members of the board (R., 23, 69). In other words, by alliance with either the wing of the Creditors' Committee representing banks or the wing representing merchandise creditors, Morris White could vote such salary to himself and his nominees, as he might see fit; and, apparently, even the requirement of such a slight alliance faded out of the picture after payment of the promissory notes, the last of which matured on July 2, 1933 (R., 27). Morris White stated that he might expect a salary as high as $60,000 a year (R., 114, 115).

The notes thus referred to were to total 20% of the proven and allowed claims of creditors, and were to be in four series. The first series were to be due on January 2, 1932; the second series on July 2, 1932; the third series on January 2, 1933; and the fourth series on July 2, 1933 (R., 27). They were all to be without interest and without security (R., 27).

The receiver's administration expenses, including the fees of itself and its counsel, were estimated at about $50,000 (R., 51, 101).

Counsel for the Creditors' Committee was to receive "a counsel fee in an amount to be agreed upon between him and the new corporation" (R., 26, 49).

The indebtedness of $158,500 in the form of taxes to the United States Government and the State of New York

(R., 101, 70, 95), was to be assumed by the new corporation (R., 26).

The Opposition to the White Offer.

At the hearings on May 26 and May 27, 1931 on the return of the order to show cause, the following creditors opposed:

1. National Surety Company, American Credit Indemnity Company and London Guaranty & Accident Company, Ltd. These companies are the insurers of certain accounts owed by Morris White, Inc. as to which claims have been filed against them aggregating $92,138.15; and the London Guaranty & Accident Company, Ltd. was on May 26 and May 27, 1931, by payment to Rex Novelty Works, a direct creditor of Morris White, Inc. in the sum of $19,329.42 (R., 136, 137, 52).

2. Hermann Loewenstein, a direct creditor in the sum of $5,600. This creditor was represented at the hearings by Mr. John S. Wise of the firm of Baldwin, Hutchins & Todd (R., 60).

3. G. Levor & Co. Inc., a direct creditor in the sum of $4,500 on a judgment (R., 111). This creditor was represented at the hearings by Mr. Raymond O'Connell of the firm of O'Connell & Butler (R., 65).

So that the total of the claims in opposition was $117,077.57, or nearly as much as the unsecured merchandise creditors represented on the Committee (R., 72). It must be borne in mind that none of the creditors' claims have yet been proven.

The total number of creditors was stated by White's counsel to be 245 (R., 91). The receiver's counsel stated that the Creditors' Committee approving the offer represented about $589,000 out of the total amount of claims (R., 51). Mr. Wise, on the other hand, in opposing the offer said (R., 66):

> "It (this Creditors' Committee) does not represent either the majority in amount nor in number, as

I understand it; and I have been at some pains to find that out."

Certainly no list or itemized statement of the creditors represented by the Committee or of the creditors approving the offer, was furnished, either by the receiver or by anyone else at any stage of the proceedings in the District Court.

The Proceedings at the Hearings on the Offer.

On May 26, 1931, Mr. Tuttle (of counsel for the dissenting creditors) opposed the offer on the following grounds:

1. The situation discloses a bankruptcy "which is nearly 100%" (R., 54).

2. The "channel of administration" should be in bankruptcy and not through an equity receivership (R., 54).

3. In view of all the circumstances, including the enormous diversions by Morris White of immense sums of money from the corporation, the creditors were entitled to that kind of examination which could only be had under Section 21A of the Bankruptcy Act (R., 54, 58, 106).

4. There had been presented no statement upon which any intelligent judgment could be based,—no appraisal of the assets, as distinct from merely bookkeeping entries at the time of the appointment of the receiver; no estimate of expenses; no proof as to the amount to be absorbed by the expenses of the receivership and the fees of the receiver and its counsel and the counsel for the Creditors' Committee; no inventory of assets; no proof as to where capital was coming from to operate the new company or on what terms such capital could be raised; no proof that the new company could operate at a profit, or even meet its liability on the notes; and no assurance as to what use Morris White would

make of the enormous power guaranteed to him (R., 52-55).

On May 27, 1931, Mr. Tuttle verified (R., 137) an affidavit which is part of the record (R., 135-137). Leave to file it was granted during the argument that day in the District Court (R., 63, 64). Attached to it was the affidavit of T. M. Garrison, assistant secretary of the National Surety Company, verified May 26, 1931, which set forth certain grounds of opposition (R., 137-141). Mr. Tuttle's affidavit added (R., 137):

> "In addition, deponent respectfully submits that the moving papers and the statements as to the financial condition of Morris White, Inc., and as to this action made upon the argument upon the return of the order to show cause, *show that this case is not one justifying an equity receivership at all; and that the court has no jurisdiction to proceed in equity.*"

The prayer of Mr. Tuttle's affidavit was that the offer be rejected; and (R., 137):

> "*Deponent further prays that the complaint herein be dismissed and the receivership vacated.*"

No Public Sale, and Competition Impossible.

What the White offer contemplated was really not "a sale" at all. Nothing was paid to either Morris White, Inc. or the creditors. No security even was given. No new money or new assets were provided (R., 26, 50).

On the contrary, it was the creditors who paid. They paid by the surrender of 80 per cent. of all their claims. They were made to buy the privilege of having Morris White, at a salary of $60,000 a year (R., 114), take all the assets of the creditors and assume control, notwithstanding that by a conversion of nearly $2,000,000 of their money to other personal ventures of his own he had brought the enterprise to complete insolvency (R., 121, 122).

But even viewing the transaction as a "sale", it was a private sale to the insolvent White and substantially on his own terms.

In point of fact, this transaction was in reality a composition in bankruptcy (National Bank. Act, Sec. 12). But the rigid requirements of a composition in bankruptcy were not complied with, e. g., that the bankrupt be examined in open court before he can have terms of composition considered, that he file a schedule of his property and a list of his creditors, that it must appear to the Court that the composition is for the best interest of the creditors, that the "bankrupt has not been guilty of any of the acts or failed to perform any of the duties, which would be a bar to his discharge," that the offer and its acceptance "are in good faith and have not been made or procured * * * by any means, promises or acts herein forbidden."

No public offering—no competition—was provided for, or under the circumstances, possible.

It is true that the order to show cause which brought the White "offer" before the Court on two weeks' notice, stated that any other offer would be considered (R., 16). But there was nothing on which anyone but Morris White could make an offer. The record discloses no inventory, no appraisal, no enumeration of claims, and no report by the receiver (R., 138, 141, 123). No date had even been fixed for the filing of claims (R., 139).

While the petition of the receiver presenting the offer set forth the mere total of the liabilities as ascertained by certified accountants (R., 32), it neither annexed nor set forth any statement whatever concerning the assets. It presented no inventory or appraisal,—not even a balance sheet or a summary of book values.

It is true that on the second day of the hearings (May 27, 1931), the counsel for the so-called Creditors' Committee presented a condensed statement of assets and liabilities (R., 61, 134) prepared by accountants as a summary *of the books* as of April 6, 1931, the day this action was

commenced (R., 134). But no one claimed that this statement of book amounts had any relation whatever to reality, —indeed, everyone conceded that it did not (R., 62, 90, 91, 95, 100, 101, 118, 119).

Even the figures of the receiver's counsel which he offered on May 27, 1931 as tending to show that the new corporation could function, were admittedly prepared by him "last night" (R., 100).

The Actual Picture was one of Bankruptcy and not of Equity.

At the time when the offer was made, Morris White, Inc. was insolvent within the meaning of the Bankruptcy Act. The roseate picture drawn by the complaint of a corporation needing only temporary assistance by a court of equity was wholly false. The cash on hand on April 6, 1931, when the complaint was filed and the temporary receiver was appointed, was only $5,600 (R., 53, 134), whereas the total liabilities, as shown upon its books, were $1,072,000 (R., 32, 52, 135).

Morris White, Inc. had "not a dollar" of orders on hand (R., 102) and the market was constantly falling (R., 51). White himself was bankrupt and his other company, Morris White Holding Co., Inc. was bankrupt (R., 86, 78, 118).

In other words, the actual picture was one of insolvency, presenting a typical case for the Bankruptcy Court and for a rigid investigation under Sec. 21-A.

In keeping with this picture, no rehabilitation of the debtor corporation was possible or was attempted. The opposite course was taken. Eighty per cent of its indebtedness to its creditors was wiped out by mere *fiat* of the court; the remaining twenty per cent was transferred to and assumed by another corporation which had no assets of its own and which received no new capital from any source. *Morris White, Inc., instead of being revived, was killed.*

No Real or Competent Proof before the District Court justifying the Acceptance of the White Offer.

All that was really before the District Court, on the part of the proponents of the offer, was *talk* and lots of it,—chiefly a well organized claque for Morris White. They filled the air with hearsay assertions, opinions, guesses and prophecies (R., 66-70, 103, 104, 108, 119); but when it came right down to "brass tacks", they did not even give the court a list of the claims alleged to be represented by the Creditors' Committee, notwithstanding that the opposing counsel challenged them to show that the Committee represented a majority either in number or amount, and asserted the contrary (R., 66).

The only *affidavits* submitted were submitted by opposing counsel (R., 135-137, 138-141). The only demands for legal proof and for an examination came from opposing counsel (R., 54, 71, 66); and these demands were opposed on the specious but significant assertion that a delay of even twenty-four hours would be prejudicial because of the alleged "seasonal" character of the business (R., 116, 118, 38, 63).

The only document submitted by the proponents of the offer was a so-called "Statement of Assets and Liabilities", prepared as of April 6, 1931, the day this suit was commenced and the receiver was appointed (R., 134). But this document was not proven in any way; it was simply made the subject of assertion by receiver's counsel and by others favoring the offer. The document itself was a mere summary of book entries. No one claimed that it portrayed in any way the actual financial condition of the Company (R., 52). Counsel for the receiver and for the so-called Creditors' Committee spoke of alleged appraisals on a going concern basis or on liquidation basis; and these in each case were much smaller than those in the said Statement (R., 61, 62, 101, 118, 119).

The receiver's counsel in expressing an opinion concerning the then present asset position of the company said (R., 101):

> "That would make a total asset position, without taking any cognizance of the miscellaneous frozen assets, intercorporate claims and so forth, of $583,-500."

as against $1,552,740.34 (R., 134) for "current assets" on the said so-called Statement of Assets and Liabilities!

Apparently, as intimated above by receiver's counsel, no one considered as of any substantial value the so-called "other assets" (totaling $2,563,510.70) summarized on the said Statement. Part of such "other assets" is a note for $1,700,000 (R., 78, 122, 61, 71, 78) made by the Morris White Holding Co., Inc., now in bankruptcy (R., 78, 52 F. (2d) 499).

The Action of the District Court on the Offer.

At the close of the hearing on May 27, 1931, the Court decided to accept the offer but granted to "each one of the opponents here an exception to my ruling" (R., 133).

The District Court imposed upon the offer the following modifications:

1. That the dividends on the preferred stock should be cumulative, beginning with the dividends payable for the semi-annual period commencing January 1, 1934 (R., 152).

2. All allowances for services in this proceeding and all fees incident to the offer and its acceptance, payable out of the estate, should be subject to the approval of the court (R., 152).

3. That Morris White file with the court a stipulation that for a period of three years he will render exclusive services to the new corporation, and that he will not directly or indirectly engage in a competing business except that he shall be free to devote his time and attention to "such realty enterprises as he may now have an interest in" (R., 152-3).

In making its decision the District Court went so far as to refuse counsel for the objecting creditors a single day's adjournment for the purpose of thoroughly examining Morris White and his associates, with their books and records, although counsel for the objecting creditors was actually engaged in the trial of an extended criminal case in which he was then about to put his client, one of the defendants, on the witness stand (R., 58, 63, 72, 106, 112, 115, 116, 117, 123).

The objection to the adjournment of a day was placed upon the ground that "every day's delay is very serious" (R., 118); and yet, although the District Court summarily disposed of this matter on May 27, 1931 (R., 130), the order confirming the so-called sale was not entered until June 15, 1931 (R., 151-155).

Decision of the Circuit Court of Appeals.

The Circuit Court of Appeals reversed only in part the order of the District Court with an opinion per Manton, C. J., 54 F. (2d) 255. The fundamental propositions of this opinion were:

1. There was no power in the District Court to compel any contract creditor to accept, in extinguishment of his claim, the preferred stock and unsecured obligations of a new industrial corporation, without the payment of any cash; and

2. The petitioners were entitled to receive in cash their proportionate share of the proceeds of a conventional sale of the property; but

3. The rights of petitioners can be satisfied by giving them in cash, in lieu of a sale, an aliquot share of what would have been realized if the property of Morris White, Inc. had been sold at public auction, or, at their option, by giving them in cash an aliquot share of the value of the preferred stock and notes offered to them by the so-called reorganization plan and as of its date.

Assignment of Errors.

Petitioners submit that the Court below erred in the following particulars:

1. In holding that the claims of the petitioners herein could be determined by estimating the amount of the highest bid which the property of the defendant corporation would have brought had it been publicly sold on June 15, 1931.

2. In failing to hold that the petitioners herein, as creditors objecting to the "reorganization" plan, were entitled to have the amounts due to them determined and paid upon an actual sale of the property of the defendant corporation.

3. In failing to hold that petitioners were entitled to have their rights administered and safeguarded in the manner in which they would have been under the Bankruptcy Act, and as of April 6, 1931.

4. In failing to hold that no part of the receivership costs or obligations should be charged against the estate of the defendant corporation before petitioners were paid the respective amounts due to them.

5. In failing to hold that no part of the attorneys' fees of any of the respondents herein should be paid out of the property of the defendant corporation before the petitioners were paid the respective amounts due to them.

6. In failing to hold that none of the property transferred to The Morris White Handbags Corp. should be subject to debts incurred by that corporation until the petitioners herein are paid in full.

FIRST POINT.

The Court below erred in holding that petitioners' rights could be fully safeguarded by an estimate of what would have been realized upon a sale, rather than by a sale itself.

I.

The decision of the Circuit Court of Appeals comes, for all practical purposes, to the same thing as the decision of the District Court.

The power exercised by the Circuit Court of Appeals is without precedent. It is the first decision of its kind.

Under that decision, a group of creditors may, through a court of equity, do what they could not possibly do under the Bankruptcy Act nor under the equity practice as it has heretofore been understood, to wit: dispense altogether with any sale, public or private; cause the assets to be transferred to a new corporation organized by themselves without new capital, money or assets; and, without making any payment, throw upon the other creditors the duty and expense of employing lawyers and accountants in undertaking to make impossible proof, namely, the amount which the assets would have realized if sold at a theoretical public sale held six months previously under terms of sale which had never been fixed, with a manner of advertising now undeterminable, and with circumstances of bidding now unknowable.

The burden and expense thus thrust upon minority creditors is practically prohibitive. Even if they undertake it, the proposition which they are required to establish can, at best, be a mere guess and undeterminable by any practical standards,—a proposition, moreover, as to which they will almost certainly be overwhelmed by a flood of interested or inspired testimony (entirely safe and easy)

from the officers and favored creditors to the effect that a public sale would have yielded little or nothing

Why should those who desire to go on with the business be entitled to place this burdensome penalty and this incalculable risk upon those who do not desire to have their capital compulsorily confiscated (without payment) for a new corporation and a new hazard over which they have no control? Why should they be permitted to deprive non-assenting creditors of that actual demonstration and proof which the conventional sale affords?

If a group of creditors desires to transfer all the assets of a purely private enterprise to a new corporation, why should they not be required to buy in the usual manner and at public sale and thus provide the capital for and take the risk of their own speculation, without the right of extorting a compulsory contribution from others or putting others to the burden, expense and delay of an impossible solution of an abstract conundrum? If such a result cannot be accomplished out of court, by what magic, in case of a purely private enterprise, can it be accomplished in court?

Dispensing with a public sale was in no sense a necessity for the assenting creditors in the present case and cannot be a necessity in any case. They were entirely free to organize their own corporation and to bid at the sale. If the property sells for little or nothing, they are advantaged. If it sells for a great deal, the non-assenting creditors are the more protected in their enjoyment of their contract rights. In either event, the law has proceeded with certainty, in accordance with the best evidence, and with fairness to all.

The difference between the decision of the Court of Appeals and the decision of the District Court is theoretically large but practically none at all. The difficulties to which the former subjects the non-assenting creditors is substantially equivalent to the exclusion which the latter imposed.

II.

The decision of the Circuit Court of Appeals is too indefinite and is impossible of performance. It substitutes guesswork for reality as a measure of rights.

(1) How can any Special Master ascertain "the value of the assets as if sold at public sale" under conditions which have long since passed and which cannot be reconstructed?

In the present case, there was at no time either an inventory, or a verified and adequate accountants' statement, or an appraisal. The failure of the District Court to require such protective proofs before proceeding to authorize the transfer, was one of the non-assenting creditors' chief complaints (R., 52, 32, 62, 90, 91, 95, 100, 101, 118, 119). Nor did the Circuit Court of Appeals have before it either inventory, verified accountants' statement or appraisal.

Why should the creditors, who properly opposed their compulsory inclusion in the paper reorganization, be now left without practical relief because of the erroneous ruling, since reversed, by which they were prejudiced?

In the interval of time since June 15, 1931, the new corporation undoubtedly consumed or sold much of the merchandise transferred to it by the decree of that date. How can an inventory of the property then transferred now be prepared? How can it now be told precisely what property was available for sale on that date? How can these petitioners, who had no connection with the business at that time, now meet the self-interested testimony which would be offered by White and the assenting group as to the identity, nature and value of the property then on hand?

Moreover, is the Special Master to determine the value of each asset at cost less depreciation? Is he to take as the standard the market value? Is he to consider what would be paid by a going business or by a junk dealer? How is he to determine how many bidders would come forward in response to advertisement, the extent and manner of

which cannot now be known? How is he to know how much the sale would have been enhanced by a proper inventory, appraisal and adequate accountants' statement which actually never existed? How could he know what would have influenced the bidders, or how good, bad or indifferent their competition would have been?

What the fair value of the property was on June 15, 1931, would (if there had been a proper inventory) be susceptible of proof; but what it would then have realized at a public sale is not now susceptible of proof. The consequences should fall, not upon those who stood upon their just rights, but upon those who illegally created the situation.

The assets of Morris White, Inc., though nominally in the custody of the Receiver, were actually in the control of Morris White and his friends. Through counsel representing adverse interests, they could claim that the assets were worth more or little as it suited their purpose. As late as May, 1932, when they filed their brief in rejoinder to petitioners' brief in this Court, respondents claimed (p. 5) that the assets of the corporation were in excess of $4,116,000, while at the same time the Morris White Handbags Corporation had already gone into bankruptcy. During the proceedings in the District Court, respondents maintained that the reorganization plan in the matter of Morris White Holding Company would yield to the creditors in this case $1,000,000 out of the $1,700,000 debt owed to the defendant, although the Holding Company was even then in bankruptcy (R., 78). That claim was made in order to influence the court to accept the offer of Mrs. Morris White.

One can go through the record in this case and trace the three sets of figures representing the assets of Morris White, Inc., i. e. the accountant's figures, the figures on a going concern basis and the figures on a forced sale basis, and see how differently the assets of the corporation could be and were represented depending on the argument urged

before the court. Under such circumstances, a fair estimate of the value of the property could hardly be obtained.

(2) There also is an insurmountable legal difficulty: *If the aliquot interests in the property estimated are less than the amount of the claims, by what right does the sole stockholder of the defendant corporation retain this enormous interest in the property?*

The decree of the court below is in conflict with the "fixed principle" laid down by this Court in *Northern Pacific Railway* v. *Boyd*, 228 U. S. 482, where this Court said (pp. 507-8):

> "The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a *fixed principle*, not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior incumbrances. * * * If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, *for dividends or only for purposes of control.* In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever." (Italics are ours).

See also:

Kansas City Terminal Ry. Co. v. *Central Union Trust Co.*, 271 U. S. 445, 454

Louisville Trust Co. v. *Louisville, New Albany & Chicago Ry. Co.*, 174 U. S. 674, 683-4.

In the case at bar, upon an estimate of the property, which as a matter of fact would leave little or nothing to the dissenting creditors, the sole stockholder has been allowed to remain in full possession and control of all the property of the corporation.

SECOND POINT.

The Court below erred in failing to hold that the property of the defendant corporation must be sold to satisfy the claims of the creditors; and erred in reversing only in part the decree of June 15th, 1931.

I.

The Decree of June 15, 1931 rested on no known Principles of Law.

With the greatest respect for the District Court, we know of no other instance where a court of equity has supposed that the appointment of a temporary receiver has suddenly clothed the Chancellor with full plenary powers of economic dictatorship in the case of a private industrial corporation.

The District Court, by its decree, undertook to exercise powers which under our constitutional system of free government have never before been exercised by any department or official,—the power to abrogate and annul accrued contractual obligations, to force unwilling parties into a new contract, to substitute stock certificates and promissory notes for legal tender, to compel business men against their will to become associates and partners in new ventures, to order owners of property to put it under the control and management of a man whom (rightly or wrongly) they regard as having been proven to be dishonest and incompetent, and to confiscate the property of minority creditors to further the purposes and interests of the majority.

The decree of June 15, 1931, we respectfully submit, was equity jurisdiction run wild. In our opinion, it perfectly typifies the "benevolent despotism" which is the inevitable result of the present monstrous growth of "friendly equity receiverships", and which the prior warnings of this Court seem to have been insufficient to check.

Such a result, we submit, must rest upon a sort of judicial magic and not upon ordered and established principles of law. A private industrial corporation, embarrassed for ready cash to meet current demands, has but to sue itself in equity through the good offices of a dummy "friendly" creditor. Then presto! All legal principles and the rights of contract and property and the freedom of individuals vanish into thin air, and their room is taken by an Authority heretofore unknown to the law—a legal anomaly, the Absolute Autocrat,—who rearranges all the rights of persons, contracts and property in accordance with his say-so as to what is "fair", and then compels every one on pain of contempt or outlawry to accept his "plan" of economic salvation.

Whence the sanction for any such Authority? Certainly the man who loans money or credit to a private industrial corporation does not thereby affect with a public interest his right to repayment according to his contract, or dedicate it to the public service. Much less does he confer upon other creditors of such a corporation a proprietary interest in his rights or a super-sovereignty over his own decisions concerning those rights. Least of all does he confer any authority upon the court to liquidate him out of the venture of his own selection by putting him into another, the hazards of which he feels himself better qualified than the judge to gauge, and the controlling personalities in which he profoundly dislikes and distrusts.

It may be (and it may not be) that in case of a quasi-public corporation exercising public franchises in aid of a necessary public service, a court of equity can find in the public nature of the enterprise a sanction not conceivable in the case of a private industrial concern. One who loans money or credit to a quasi-public corporation may possibly be said to affect it with a public interest and to subject it in part to the public's proprietary interest in the enterprise as represented by the public franchises. In such case a court of equity might possibly find an excuse as a guardian

of the public right to require private right to pursue certain settled standards in the interest of the public good.

Furthermore, a quasi-public corporation (such as a railroad) is outside the Bankruptcy Law, and therefore as to it insolvency administration must be in equity or be nowhere. On the other hand, private industrial corporations are expressly included within the exclusive insolvency administration provided by the Bankruptcy Law; and the interposition of equity, except to aid in the execution of judgments not voidable in bankruptcy, is usurpation and in effect a nullification of the Bankruptcy Law.

If the decree of June 15, 1931 is legally possible in the case of a private industrial corporation, why is it not also possible in the case of a private individual? Why does it not open the door for every debtor, corporate or individual, through the easy subterfuge of a "friendly equity receivership" to secure a nullification of his debts, and to compel his creditors to take in payment such promissory notes and stock certificates as some equity judge may think "fair" and for "the good of all concerned"? If so, what becomes of the Bankruptcy Law, with its carefully balanced safeguards and procedures?

If private property cannot be taken for a public use without compensation, *a fortiori* it cannot be taken for the private use of someone else, or for a compensation which is not legal tender.

The order of the District Court, if regarded as giving the creditors "payment" (to use the euphemism of the White offer, R., 18), does so by compelling them to accept paper not legal tender under the statutes of the United States.

On the other hand, if the decree of June 15, 1931 does not "pay" the debts to the extent of the insolvent's financial ability, then it asserts the power to wipe out the contracts by which credit was extended to the corporation, and to tell individuals what stocks they must buy, what new commercial hazards they must undertake, and with what co-

adventurers they must embark. It treats the assets of an insolvent commercial corporation as a trust fund for the benefit of the debtor instead of the creditors.

The doctrine that a court of equity is a court of conscience does not mean that it is a court of general benevolence, or a censor of morals, or a general guardian of business men.

As to public policy, in the long run it is, we submit, more to the interest of the public and the parties to permit business men to make their own contracts by the usual process of give and take, than to have their contracts written for them by paternalistic judges however competent and well intentioned they may be.

Adoption of the principles of the order of the District Court would, in the last analysis, mean that the security behind an extension of open credit is the unpredictable judgment of some judge in equity. Business men will not advance such credit to private commercial corporations if they feel that they are not able to contract that, when disaster comes, they may decide for themselves whether to take their proportionate share in money or embark their capital in some new enterprise. Certainly lawyers would, in such event, be obliged to confess their inability to advise their clients as to either their "rights" or their just expectations in law. They would have to say that even as to contract and property rights the law is not a science but merely what *a judge may think* "fair and equitable" (R. 152).

II.

The decisions deny the power exercised in the decree of June 15, 1931.

No precedent whatever can be found for that decree—certainly not in the case of a private commercial corporation, possessing no public service franchises and affected with no public interest. The decisions are all to the very contrary.

In *Manhattan Rubber Mfg. Co.* v. *Lucey Mfg. Co.*, 5 F. (2d) 39, Judge Learned Hand (refusing to follow *Graselli Chemical Co.* v. *Aetna Explosives Co.*, 252 Fed. 456), said (p. 43):

> "They (creditors' bills in equity) are as much *limited by law* as any others, and there is in my judgment no warrant either in principle or policy, for asserting that, once a receiver is appointed, the court takes on the part of *a benevolent despot.*"

In *In re Prudential Outfitting Co.* v. *Delaware*, 250 Fed. 504, Judge Learned Hand said (pp. 506-7):

> "Upon principle the question is clear. Bankruptcy does not change the character of the creditors' claims, which are measured by, and collectible in, money. It does insure equality of distribution and modify the creditors' remedies, but there is no shadow of warrant for the idea that an interest in property may be forcibly imposed upon them in place of money. They have the right, as they had before, to have those assets converted into money, collectively instead of separately, and nothing can invade or impair that right, unless it be by statute. * * *
>
> "The conventional form of reorganization does justice to dissentient creditors, and all efforts to avoid or evade it are illegal. Under it a new corporation is formed by those creditors who wish to join the plan, and who assign their claims to it or to their committee. This corporation or committee may then make *a cash bid*, which it may in part pay by allowing a proportionate credit upon the assigned claims. *The dissenting creditors must be paid in cash their own proportion of the bid, which is their inviolate right.*"

In *Guaranty Trust Co.* v. *International Type Setting Co.*, U. S. D. C., Southern District of New York, February 1916 (not officially reported), Judge Hough, in the case of an industrial corporation, said:

> "There is a good deal to be said in favor of a new scheme of law which would in some way confer

> upon an impartial and disinterested tribunal the entire supervision of corporate reorganization. * * * *But no such system of legal procedure now exists.*"

In *Safety Car Heating & Lighting Co.* v. *U. S. Light & Heating Co.*, 2 F. (2d) 384, the reorganization was of an industrial company. Judge Hazel held (to quote the first headnote):

> "A reorganization of an insolvent corporation, whether by agreement between stockholders and creditors or through court procedure, *cannot affect nonassenting creditors*, and its assets in the hands of the new company remain subject to a lien for their claims."

In *In re Northampton Portland Cement Co.*, 185 Fed. 542, Judge J. B. McPherson said (p. 543):

> "There is no inherent power in the court to compel minority creditors to give up legal property rights, and in their stead to accept securities and incur liabilities which have already been declined. * * * They (reorganizations of this kind) may be desirable; but the creditors must determine that for themselves. The usual course of administration may be certain to result in heavy loss; but the court must pursue that course unless the act has authorized the use of exceptional means."

To the same effect are:

In re J. B. & J. M. Cornell Co., 186 Fed. 859;
In re J. B. & J. M. Cornell Co., 201 Fed. 381, 387;
In re Sale of Assets of First National Bank of Florence, 6 F. (2nd) 905, 909;
Merchants' Loan & Trust Co. v. *Chicago Rys. Co.*, 158 Fed. 923, 927;
Gay v. *Hudson River Elec. Power Co.*, 184 Fed. (C. C. A. 2nd Cir.) 689, 694;
Odell v. *H. Batterman Co.*, 223 Fed. (C. C. A. 2nd Cir.) 292, 297;

Okmulgee Window Glass Co. v. *Frink,* 260 Fed. (C. C. A. 8th Cir.) 159;
Baker Motor Vehicle Co. v. *Hunter,* 238 Fed. (C. C. A. 2nd Cir.) 894, 898;
Mountain States Power Co. v. *A. L. Jordan Lumber Co.,* 293 Fed. (C. C. A. 9th Cir.) 502;
Kneeland v. *American Loan Co.,* 136 U. S. 89, 97.

III.

The Boyd case, 228 U. S. 482.

(1) The *decision* in the *Boyd* case (which concerned a public service corporation and not a private industrial corporation) is a square authority against the decree of June 15, 1931. The decision settled three principles of law:

> 1. "As between the parties and the public generally, the sale was valid. *As against creditors, it was a mere form.* Though the Northern Pacific Railroad was divested of the legal title, the old stockholders were still owners of the same railroad, encumbered by the same debts. The circumlocution did not better their title against Boyd as a non-assenting creditor. They had changed the name but not the relation. The property in the hands of the former owners, under a new charter, was as much subject to any existing liability as that of a defendant who buys his own property at a tax sale" (pp. 506, 507).
>
> 2. "The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided *according to a fixed principle,* not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances" (p. 507).
>
> 3. "Even in the absence of fraud, any device, whether by private contract or under judicial sale, whereby stockholders are preferred to creditors, is invalid" (p. 482).

The decree of June 15, 1931, violates these three principles. The so-called sale "was a mere form". It slightly "changed the name but not the relation". The "old stockholder" (White) still remained owner of the assets and was confirmed and continued as such. The creditors, so far from being paid or preferred, had their claims forcibly cancelled to the extent of 80% and their capital subjected to a forced levy.

(2) On the other hand, the *dictum* in the *Boyd* case relative to the consequences to an unsecured creditor if he declines to participate in a "fair" reorganization, lends no support to the decree of June 15, 1931, and in any event has no application to the case of a private industrial corporation.

This *dictum* does not hold that the dissenting creditors are not entitled to a conventional sale upon public notice with full inventory and advertisement. It was written in the case of a public service corporation, and merely says that where there has been such a sale, the dissenting creditors may, nevertheless, not follow the assets where the reorganization plan provided for obtaining new money and made a fair and equitable offer to the creditors. In the present case there was no reorganization plan in any such sense and certainly there was no such sale. The *Boyd* case describes the sale then before the court as one made "at public outcry" (p. 507).

THIRD POINT.

The Circuit Court of Appeals also erred in not pursuing the logic of its own decision and in not adjudicating that the petitioners were entitled to follow the assets and secure from them a full payment of their claims and not merely an aliquot share of what might possibly have been realized at a theoretical auction sale held six months previous.

(1) We attach to this brief as an appendix the order made by the District Court under date of February 2nd, 1932, on the mandate of the Circuit Court of Appeals. This Court will see therefrom that all that has been allowed these petitioners is an aliquot share of some estimate by a special master as to what the assets of the Morris White, Inc. would have brought at public auction on June 15, 1931, after deducting from such estimated sum

> (1) the costs and obligations of the Receiver up to June 15, 1931;
>
> (2) the costs of the appeal to the Circuit Court of Appeals;
>
> (3) an estimate of the cost of a sale of the assets as of June 15, 1931, and
>
> (4) the claims of the United States and the State of New York for taxes.

In other words, the District Court ordered that the hypothetical proceeds of a hypothetical sale be estimated and that certain deductions be made therefrom, and left it entirely problematical whether as a result the petitioners would be paid anything at all.

In addition, the probability of these petitioners receiving nothing was vastly increased by the provision of the said order that those persons who after June 15, 1931, had, or might, become creditors of the Morris White Handbags Corp. in the regular course of business should "be entitled

to priority of payment out of the assets of The Morris White Handbags Corp. other than such assets as were transferred to the said The Morris White Handbags Corp. pursuant to said order dated June 15, 1931." The effect of this order was that if the whole or major portion of the merchandise of Morris White, Inc. were on and after June 15, 1931, sold or used up in the current business of the Morris White Handbags Corp., then the new creditors of the latter would have priority in its assets; and such priority would render substantially valueless the lien given by the said order to these petitioners for the payment of their aliquot share in the proceeds of the hypothetical sale.

(2) We respectfully submit that no such destructive limitations on the rights of these petitioners is permissible. Since, under the decision of the Circuit Court of Appeals the so-called White Plan is not in any way binding upon these petitioners, these petitioners as creditors of the Morris White, Inc. are entitled to pursue its assets wherever they may be found and are entitled to payment from the said assets or from any other property (cash or merchandise) which was substituted for them. The fact that these petitioners did not assent to the transfer of the assets of the Morris White, Inc. to The Morris White Handbags Corp. and did not assent to the decree of June 15, 1931, was a matter of public record and of public notice and knowledge; and all persons who undertook thereafter to become creditors of The Morris White Handbags Corp. had notice or were chargeable with notice of the claims of these petitioners and should have been deemed to have taken the risk of being held to have acted in subordination thereto.

The creditors of the Handbags Corp. could have no greater right in the assets of the Morris White Inc., or in the proceeds of such assets than the Handbags Corp. itself held; and the Handbags Corp. took those assets (for which it paid nothing to the Morris White, Inc.) and held them and any proceeds into which they were converted subject to claims of these petitioners as creditors of Morris White, Inc.

The Morris White Handbags Corp. was in no sense a purchaser for value. It paid nothing to the Morris White, Inc. It stripped the latter of all its assets without substituting any money, any legal tender, or indeed any thing at all, in their place.

The decree of June 15, 1931 ("reversed" by the Circuit Court of Appeals) attempted to cut off altogether the rights of these petitioners as creditors of the Morris White, Inc. to be paid out of its assets wherever they might be found (or out of the proceeds of the sales thereof in due course and for value) by interposing the decree's acceptance of the so-called White Plan. Consequently, the moment it was held that that plan and its acceptance was not a legal and valid bar to the petitioners' right of recovery, then these petitioners had the right to pursue full payment of their claims from the said assets of The Morris White, Inc. and the proceeds thereof until and unless they reach the hands of a purchaser for full value and without notice.

(3) To this result none of the creditors of the Morris White, Inc., who were such on June 15, 1931, could lawfully object. In the first place, those contemporaneous creditors (or at least those represented by the creditors committee and those individually assenting to the White Plan) have voluntarily surrendered their position as creditors of The Morris White, Inc. and have voluntarily undertaken to become creditors and stockholders solely of the Morris White Handbags Corp. In consequence, their rights are now, and from the time of their assent to the said plan, have been solely in and by derivation from the Morris White Handbags Corp.; and this latter corporation took, and must be held to have taken, the assets of the Morris White, Inc. subject and in subordination to the rights of these petitioners therein as creditors of Morris White, Inc. In other words, the assenting contemporaneous creditors can have no greater claim as of June 15, 1931, in what formerly were the assets of the Morris White, Inc. than has The Morris White Handbags Corp., as to which they voluntarily elected to become creditors and stockholders in lieu of their former position as creditors of the Morris White, Inc.

In the second place, by adopting and assenting to the White Plan and by going forward therewith and effectuating the transfer of assets with knowledge and notice that these petitioners were not assenting thereto, and with notice that the transfer was, or might be judicially determined to be, invalid in law as to these petitioners, the said assenting creditors must be deemed voluntarily to have placed themselves in subordination to the just claims of these petitioners and to have taken the risk of the outcome of the appeal which these petitioners duly took and pending which they obtained a stay.

In the third place, the said assenting creditors not only elected voluntarily to become creditors of The Morris White Handbags Corp. in lieu of being creditors of the Morris White, Inc., but they *actually scaled down and cancelled eighty per cent of their claims* and took stock of The Morris White Handbags Corp. in lieu of the said eighty per cent. *In consequence, to the extent of eighty per cent of their original claims they are not now creditors either of the Morris White, Inc. or of The Morris White Handbags Corp.*

Hence, even if (contrary to our claim) the rights of these petitioners be limited to aliquot shares in some fund and do not extend so far as to permit pursuing the assets for payment in full, then nevertheless such aliquot shares must be computed on the basis that the assenting creditors have voluntarily taken stock and notes of the Handbags Corp. in extinguishment of their claims against the Morris White, Inc. Those assenting creditors cannot now recall their election and cancel their substituted investment, for the purpose of cutting down the proportional rights of these petitioners to payment. In other words, in a homely phrase, the assenting creditors cannot eat their cake and have it too.

The Circuit Court of Appeals therefore clearly erred, even on its own logic, in holding that in measuring the aliquot share of these petitioners in the proceeds of a hypothetical sale as of June 15, 1931, the claims of all the June 15th creditors of the Morris White, Inc. should be

taken at one hundred per cent and should be given equality of standing with the claims of these petitioners for the purpose of cutting down the rights of the petitioners to payment and of limiting the amounts of such payments to them.

(4) The same considerations apply to the claims of the Federal government and the State government for taxes. Both these governments took what they evidently considered to be the benefits and advantages to them of the said decree of June 15, 1931, and thereby in effect became parties to the said decree; and they have not undertaken to appeal therefrom. This decree provided (R., 153) that at or before the transfer of the assets to The Morris White Handbags Corp. the latter should deliver for the benefit of the Federal and State governments an agreement to assume the taxes due from Morris White, Inc. and to consent that such taxes might be assessed against the new corporation.

The Federal and State governments elected to take advantage of these provisions for their assumed benefit; and the Federal government signed a written consent to the transfer of the assets, to the discharge and absolution of the receivers of Morris White, Inc. for all liability for taxes and to the acceptance of an agreement by The Morris White Handbags Corp. to pay the taxes (R., 155).

The record indicates that a similar consent was obtained from the State government (R., 101, 133), and the decree of June 15th itself so establishes, because in paragraph Third thereof it provides (R., 154):

> "Third. Upon the transfer of the assets of the defendant by the Receiver pursuant to said offer, the Receiver shall forever be released, discharged and absolved from any and all liability whatsoever to the Government of the United States and to the State of New York for, by reason of, or in any way arising out of any past, present or future claim for taxes or otherwise against Morris White, Inc. and/or against Irving Trust Company, as Receiver of Morris White, Inc."

(5) It seems to us that no authorities are necessary for the purpose of establishing the foregoing plain and obvious

propositions. The assenting creditors were not compelled to accept the White Plan or to give up their claims against the Morris White, Inc. and take in substitution claims against The Morris White Handbags Corp. They were not compelled to reduce their claims by eighty per cent. and take in lieu thereof stock in The Morris White Handbags Corp. They clearly cannot now take both positions at the same time, and cannot now be creditors of both corporations at the same time. By their own act in investing in accordance with their own choice in The Morris White Handbags Corp., they cancelled, annulled and destroyed forever and for all purposes their original position as creditors of Morris White, Inc. and therefore cannot interpose for any purpose their original claims against Morris White, Inc. in reduction of the claim of these petitioners to payment from the assets of Morris White, Inc. Thereby they (even including the Federal and State governments) elected that their positions should be as creditors and stockholders solely of The Morris White Handbags Corp. In consequence they could have in the assets of Morris White, Inc. or in the proceeds of such assets no greater or superior claim as against these petitioners than The Morris White Handbags Corp. itself had; and, in view of the invalidity of the transfer of these assets as against these petitioners, the Morris White Handbags Corp. took, and must be deemed to have taken, those assets in entire subordination to the rights of these petitioners.

The case of *Northern Pacific Rwy. Co.* v. *Boyd*, 228 U. S. 482, 502, 506, proceeded on similar reasoning to a similar result. There it was held that notwithstanding a transfer of assets under a plan of reorganization had actually taken place, all non-assenting creditors could pursue those assets and recover from them the full amount of their claims, inasmuch as the plan of reorganization was invalid as to them and in consequence no bar to such recovery.

The case of *Howard* v. *Maxwell Motor Co.*, 269 Fed. 292, aff'd. 275 Fed. (C. C. A. 2nd) 53, is to the same effect.

FOURTH POINT.

In any event, and even if we are wrong in the foregoing contentions, the Court below should nevertheless have reversed the decree of June 15th, 1931, on the ground that, at the hearings on which that decree was heard, the case was disclosed to be one for a court of bankruptcy or, at least, not one for a court of equity.

In any event, the Court below should have adjudicated the rights of the parties as if the case were in bankruptcy.

I.

The case should have proceeded in bankrupty, or, at least, should not have been continued in equity.

(1). As already said (statement of facts, pp. 32, 52, 54, 58, 106, *supra*) the petitioners through their counsel repeatedly urged the District Court that the artificial language of the complaint and answer denying insolvency was a mere sham and a patent device to avoid the judicial sale required by the Bankruptcy Act and the other protections which that Act gives to unsecured creditors. In addition, Mr. Tuttle, petitioners' counsel, filed an affidavit pursuant to leave granted on the argument (R., 63, 64). This affidavit after setting forth certain grounds of opposition to the White offer, added (R., 137):

> "In addition, deponent respectfully submits that the moving papers and the statements as to the financial condition of Morris White, Inc. and as to this action made upon the argument upon the return of the order to show cause, *show that this case is not one justifying an equity receivership at all; and that the court has no jurisdiction to proceed in equity.*"

The prayer of Mr. Tuttle's affidavit was that the offer be rejected; and

> "Deponent further prays that the complaint herein be dismissed and the receivership vacated."

(2). Hence there is presented in this case the important question whether or not a federal court of equity, in a spirit of benevolence, is to take over the jurisdiction and subject matter committed by the Bankruptcy Act exclusively to courts of bankruptcy; or whether, on the other hand, a federal court of equity is to follow the traditional doctrine that it will conduct a receivership of corporations of the purely commercial class only for the purpose of a temporary moratorium and to conserve the assets with a view of the company's early rehabilitation.

In *Michigan ex rel. Michigan Trust Co.* v. *Haggerty*, 286 U. S. 334, this Court ponted out the grave importance of these considerations, Judge Cardozo saying at p. 345:

> "This court has had occasion to point out the abuses that can arise from friendly receiverships forestalling the normal process of administration in bankruptcy and enabling a tottering business to continue while creditors are held at bay, * * *. Receiverships for conservation have at times a legitimate function, but they are to be watched with jealous eyes lest their function be perverted."

This Court has authoritatively declared against so-called "friendly equity receiverships" based upon a complaint where the complainant was not a judgment creditor after a return of "*nulla bona*" on execution; and has made an exception only where lack of seasonable objection has permitted the receivership to continue for so long that irreparable damage would follow the vacating of it.

Thus, in *Harkin* v. *Brundage*, 276 U. S. 36, this Court said at p. 52:

> "We do not wish what we have said to be taken as a general approval of the appointment of a receiver under the prayer of a bill brought by a simple contract creditor simply because it is consented to at the time by a defendant corporation. The true rule in equity is that under usual circumstances a creditor's bill may not be brought except by a judgment creditor after a return of '*nulla bona*' on execution.

> When a receiver has been thus irregularly appointed on such a bill without objection, and the administration has proceeded to such a point that it would be detrimental to all concerned to discharge the receiver, the receivership has been permitted to continue because not seasonably objected to."

In the present case this "friendly equity receivership" was not only "seasonably objected to", but the courts below had before them ample proof that, as the petitioners urged, the administration of the estate properly belonged in the bankruptcy court or, at least, not in equity.

(3). It seems to us that the dangerous tendencies and erroneous conceptions of law involved in the precedent established by the decisions below were well analyzed and condemned by Judge Woolsey in *Municipal Financial Corporation* v. *Bankus Corporation*, 45 F. (2d) 902, and *Matter of Bankus Corporation*, 45 F. (2d) 907. There, as here, the equity proceeding was a so-called "friendly" one, instituted by a handy non-resident creditor professedly to secure a moratorium. There, as here, the complaint alleged that there was an actual excess of assets over liabilities, and that the difficulty was merely a temporary shortage of sufficient funds. But there, as here, it speedily developed, *immediately after the appointment of the receiver*, that the financial situation was altogether of a different character; that there was no relation between the book values and the intrinsic values; that the liabilities far exceeded the market value of the assets; and that the cash on hand was wholly inadequate for runing the company, to say nothing of paying its debts. Hence, notwithstanding that Judge Woolsey had himself appointed the receiver in equity, he decided that the facts subsequently revealed should move him as chancellor to vacate the receivership, wash his hands of the case, and recommend the parties to a Court of Bankruptcy. To quote his opinion (p. 906):

> "Here, on the facts as developed by the receiver's investigations, there is shown a variance—fatal

to the equitable relief here sought—between the admitted allegations of the complaint and the actualities of the situation which they purported to set forth.

"*There is not any right of sanctuary in an equity receivership in the federal court.*

"Such a receivership is merely *an extraordinary remedy* which involves taking a party under the protection of the court primarily for the purpose of allowing it a *moratorium* in order that it may work out its rehabilitation. It involves the possibility of savir the situation by allowing the moratorium, and necessitates sufficient funds to enable the receiver to carry on in the meantime."

The conclusion of Judge Woolsey's reasoning was thus stated by him (p. 906):

> "In these circumstances, applying the views which are expressed by the Supreme Court in the cases of *Harkin* v. *Brundage*, 276 U. S. 36, 51, 52, 48 S. Ct. 268, 72 L. Ed. 457, and *Pusey & Jones Company* v. *Hanssen*, 261 U. S. 491, 497, 500, 43 S. Ct. 454, 67 L. Ed. 763, I feel that I must terminate these receiverships, leaving it to the defendant corporations and their directors, stockholders and creditors to work out the solution of a situation with which I feel this court, sitting in equity, cannot properly be asked to cope."

(4). In *Harkin* v. *Brundage*, 276 U. S. 36, this Court laid down the following rule concerning the so-called "friendly" receiverships by consent (per Taft, C. J.; p. 55):

> "The desire of those who represent an embarrassed corporation to seek a refuge from active and urgent creditors under the protecting arm of an officer of the court, leads to strenuous efforts to frame a case which may under equity practice justify a receiver. * * * The temptation of the exercise of power and patronage in the selection of receivers and the management of great businesses under the court should not be a feather's weight in prompting court action."

In *Wheeler* v. *Badenhausen Co.*, 260 Fed. 991, the Court said:

> "There is a clear distinction between a receivership on the ground of insolvency and one for conservation of assets and rehabilitation for the benefit of creditors."

(5). *A fortiori*, a federal equity court has no power to perform the functions of a court of bankruptcy. A long line of authorities repudiate the idea that a federal court of equity has concurrent jurisdiction with a bankruptcy court or may substitute for it.

In Re Watts, 190 U. S. 1 this Court said (p. 27):

> "The operation of the bankruptcy laws of the United States cannot be defeated by insolvent commercial corporations applying to be wound up under state statutes. The bankruptcy law is *paramount*, and the jurisdiction of the federal courts in bankruptcy, when properly invoked, in the administration of the affairs of insolvent persons and corporations, is *essentially exclusive.*"

(6). The following is taken from the "Annual Report of Special Committee on Equity Receiverships for 1926-27 appointed by the Association of the Bar of the City of New York", Year Book 1927 of the Association of the Bar, pp. 299, 321:

> "The function of the equity receivership, as your Committee conceives it, is to conserve the assets of a corporation really solvent but temporarily embarrassed financially until a plan of refinancing, rehabilitation or reorganization can be evolved. The use of such receiverships in cases where liquidation is inevitable or the continuance of such receiverships after hopeless insolvency becomes apparent involves, we think, the usurpation of the powers intended by Congress to be exercised by the bankruptcy court."

Similar articles denouncing the growing abuses of "friendly" equity receiverships have appeared in Yale

Law Journal, Vol. 19 (1910) p. 276, and in the Connecticut Bar Journal (1920-29) p. 1, under the heading "Equity Receiverships in the United States District Court for Connecticut."

II.

In Any Event, the Petitioners' Rights Should Have Been Administered and Safeguarded as in the Bankruptcy Act.

The question whether the rights of creditors in a so-called friendly equity receivership proceeding are to be administered and safeguarded as in bankruptcy, petitioners submit, has been answered by this Court in the affirmative in *Price, Receiver* v. *United States*, 269 U. S. 492 and *United States* v. *Butterworth-Judson Corp.*, 269 U. S. 504. There the question was whether the Government was entitled to priority on its claims for taxes under Sec. 3466 R. S. It was argued by the opponents that, while the Government was entitled to priority in bankruptcy, it was not entitled to such priority in a receivership proceeding. This Court held in favor of the Government.

It held that when the complaint was filed by a simple contract creditor, praying for the appointment of a receiver, the plaintiff could not have the relief sought without the consent of the defendant; that when the defendant consented to an appointment of the receiver, the consent was tantamount to an assignment for the benefit of creditors (which was an act of bankruptcy); and the creditors were entitled to payment in accordance with their "rights and priorities". It follows that in cases of friendly receiverships instituted by simple contract creditors with the consent of the defendants, the result is inescapable that the rights of creditors are to be administered and safeguarded as provided in the Bankruptcy Act. That is our case.

An opposite conclusion would lead to absurd results. It would mean that the rights of creditors under the Bankruptcy Act could be defeated by mere agreement between the corporation (bankrupt in fact) and one of its creditors,

to bring suit and allege that the bankrupt while financially embarrassed, is really solvent and get a receiver appointed. The bankrupt, by consenting to the proceeding, waives the defense of an adequate remedy at law, *and the court of equity becomes the business manager of the corporation with powers to disregard the rights of creditors.*

Whether there are any constitutional limitations on the exercise of such power is a question which we need not raise here. But we seriously doubt that Congress, in passing the Bankruptcy Act, contemplated that the rights of creditors thereunder could be suspended by receivership proceedings.

There were a number of rights and safeguards guaranteed by the Bankruptcy Act, of which petitioners were deprived by the order of the District Court approving the reorganization plan. But the Circuit Court of Appeals gave these petitioners no relief.

(1) *Preferential Payments.*

Under the Bankruptcy Act preferential payments are prohibited (Secs. 60a, 3 a2). In this case the defendant had assigned accounts receivable to its bank creditors, and the District Court did nothing to set aside those preferences. The Circuit Court of Appeals ordered that petitioners be afforded an opportunity to question the assignment of accounts (R., 173), but the District Court also permitted, *nay directed*, a preferential payment to a judgment creditor (R., 47), and immediately after the reorganization plan was approved, the Court also approved payments in full to a large number of small creditors (R., 132). The Circuit Court of Appeals failed to order that those preferences be set aside as a fraud upon the non-assenting creditors and as a violation of the Bankruptcy Act.

(2) *Administration Costs Excessive.*

Under the Bankruptcy Act the charges of the administration of the bankrupt estate and for counsel fees are care-

fully supervised (Secs. 48, 72 G. O. XXXV, XLIII), and are subject to objection on the part of creditors (G. O. XLII).

At the time when the "reorganization" plan came before the District Court, which was only seven weeks after the temporary receiver was appointed, the receivership costs were estimated at $50,000, and, above that, an indeterminate amount to counsel for the creditors' committee (R., 51).

In addition, the estate was subjected to an annual charge of $60,000 in the form of a salary for Morris White himself. The District Court thought this amount was "quite large," but did nothing to reduce it to a proper level (R., 114, 132, 152). The Circuit Court of Appeals likewise made no provision that the estate should not be taxed with exorbitant fees and other charges.

(3) *No Judicial Appraisal.*

Under the Bankruptcy Act the bankrupt estate must be appraised by disinterested appraisers, and the appraisals must be made available to the creditors (Sec. 70b). In this case no proper inventory was ever given to the court, nor was a judicial appraisal ever made. Petitioners time and again had demanded at least a certified statement of the assets and liabilities of the defendant corporation (R., 112, 123, 125), but no one would certify to the statement submitted, except for the unitemized certificate of the accountant as to the liabilities.

The District Court refused to direct that petitioners be furnished with a disinterested statement of the defendant's financial condition.

The Circuit Court of Appeals made no provision that petitioners be safeguarded in this requirement of the Bankruptcy Act. It ordered on Dec. 2, 1931, that an *estimate* be made as of June 15th, 1931, of property which was in the hands of respondents from April 6, 1931, when at neither of those dates was there any definite evidence as to the assets and liabilities of the corporation. In this connection, it must also be remembered that throughout the

proceedings the values of the assets of the corporation, as represented, depended largely on the purposes which the respondent sought to accomplish.

(4) *No Bona Fide Sale.*

Under the Bankruptcy Act a bona fide sale of property must be made prior to distribution (Secs. 64, 70(b)). It has already been shown that there was no sale (pp. 26, 50, *supra*). Petitioners repeat here that, if there is any doubt as to the necessity of ordering a sale of the assets of the corporation which is not subject to the Bankruptcy Act, there can be no doubt as to the requirement of a sale in the case of an insolvent private commercial corporation in a voluntary receivership (see pp. 25-31, *supra*).

(5) *No Opportunity for Examination of Bankrupt.*

Under the Bankruptcy Act, if a composition is allowed, then the bankrupt must file a schedule of assets and liabilities, and must subject himself to an examination at a meeting of creditors (Sec. 21(a), Sec. 12(a)). In this case there was no examination similar to that conducted under Sec. 21-A of the Bankruptcy Act. Petitioners constantly requested an opportunity to examine Morris White under oath (R., 54, 62, 106), and the District Court, after having stated that it would hear testimony or appoint a special master (R., 63), for some inexplicable reason changed its mind, and itself undertook to examine Morris White, without giving petitioners an opportunity for an intelligent examination, with Morris White and his associates and all books and records in Court, so that a certified public accountant could go into the matter thoroughly.

It will be noted that the statement of assets and liabilities submitted to the court (R., 134-5) contained an asset of $156,520.53 as debts due from officers and employees. After the perfunctory examination of Morris White by the court, counsel for one of the creditors elicited from counsel for the Receiver that Morris White himself owed over $137,700 to the corporation (R., 122). In addi-

tion to that, an amount of $2,277,714.89 was listed as investments in and advances to subsidiary and other associated companies (R., 134), and counsel for one of the creditors elicited that of this amount $1,700,000 was owed by the Morris White Holding Co. Inc. (R., 122). Morris White refused to state when he expected that amount to be paid, but evaded that question (R., 122-3); and then it became evident that an intelligent examination of the witness could not be conducted without the figures which petitioners had sought to obtain.

The refusal of the District Court to grant a reasonable continuance for that purpose was a clear abuse of discretion. Here all the evidence was in the possession of the receiver, represented by counsel who also represented the friendly complainant, and a reasonable time was necessary to gather the data for an intelligent examination. The Circuit Court of Appeals did not require that petitioners be afforded that opportunity.

(6) *Reorganization Not Accepted by Majority of Creditors in Amount.*

Compositions must be accepted by a majority of creditors both in number and amount (Bankruptcy Act, Sec. 12(b)). Here petitioners had no reason to believe that the "reorganization" plan was approved by a majority of creditors in number and amount. Yet, neither the district court nor the Circuit Court of Appeals required respondents to prove that the creditors committee was in a position to say to the court, as it did (R., 82):

> "Never mind the few objectors; in no proposition can we get 100%."

(7) *No Security Furnished.*

Under the Bankruptcy Act, security must be furnished by the bankrupt for the discharge of obligations assumed in a composition (Sec. 12(b)). In this case, the District Court approved the "reorganization" plan, which merely

reduced the claim of all the creditors, except claims for taxes, to twenty per cent. of their respective amounts. No security whatsoever was offered, nor did the District Court require any security for the payment of the obligations assumed by the new corporation. The Circuit Court of Appeals likewise left petitioners unprotected against any dissipation of the assets.

(8) *Diversion of Corporate Assets.*

Under the Bankruptcy Act, no composition may be approved, if the bankrupt is found guilty of such acts of commission or omission as would constitute a bar to his discharge in bankruptcy (Sec. 12(b) and Sec. 14(b)). In this case, it appeared, Morris White "took", as he stated, over $2,000,000 from the defendant corporation and "gave" it to the Morris White Holding Co. Inc. without any regard whatsoever to the rights of the creditors of the former corporation. Petitioners had no opportunity to examine Morris White fully on this transaction. The District Court considered the transaction improper, but did not hold Morris White liable to the creditors for the corporate funds diverted by him. This fund, together with the other assets, might have been sufficient to pay all the debts of the corporation. Nor did the District Court direct the receiver to press the claim against the Morris White Holding Co. Inc. or Morris White himself, or both. Instead, the entire plan seems to have been to condone this diversion of corporate funds at the expense of the creditors and to cancel the claim of the corporation. The Circuit Court of Appeals made no provision whereby petitioners should follow the assets of the defendant.

These were the rights and safeguards to which petitioners were entitled, and of which they were deprived. Petitioners maintain that if the assets of Morris White, Inc. are not sufficient to pay their claims in full, they should be safeguarded in their rights granted to them under the Bankruptcy Act as if the case had proceeded in bankruptcy.

FIFTH POINT.

The Circuit Court of Appeals erred in failing to reverse the decree of the District Court in so far as it held that the receivership costs, the fees of the attorneys for the receiver, and all other fees incident to the White offer and its acceptance, should be paid out of the Estate. No portion of these charges should, directly or indirectly, be thrown upon these petitioners or upon the amounts they are entitled to receive.

In approving the "reorganization" plan, the District Court held that "all allowances for services rendered or to be rendered in this proceeding, and all other fees incident to said offer and its acceptance" should be "payable out of the assets of this estate" (R., 152, 19, 20, 26). Thereby the allowances were given a priority. The Circuit Court of Appeals did not disturb that ruling.

In other words, in accordance with the White plan (R., 26), the petitioners who opposed the plan were in effect required to pay an aliquot share of the expenses of the receivership costs, of the fees of the receiver's counsel, and of the fees of the counsel for the Creditors' Committee supporting the plan (R., 26).

I.

The receivership costs should not be paid out of the Estate. At least, no portion thereof should be thrown upon these petitioners, directly or indirectly.

The avowed purpose of the receivership was to preserve the assets of the corporation for the benefit of the creditors. It was, therefore, the duty of the receiver and its counsel to be a neutral party to any plan proposed by Morris White or by any creditors friendly to him.

Booth v. *Clark,* 17 How. 322, 331;
Davis v. *Gray,* 16 Wall. 203, 218;

Quincy etc. R. R. Co. v. *Humphreys,* 145 U. S. 82, 91-2;
Equitable Trust Co. v. *Great Shoshone & Twin Falls Water Power Co.,* 245 Fed. 697; 249 Fed. 967;
Pennsylvania Steel Co. v. *N. Y. City Ry. Co.,* 198 Fed. 721, 728;
High on Receivers (4th Edition) p. 3;
Beach on Receivers (2nd Edition) p. 7.

In the present instance, a receivership ostensibly "for conservation and rehabilitation" was almost immediately converted, with the active cooperation of the counsel for the receiver, into a situation where the defendant corporation was promptly given the lethal blow and "liquidated" by a transfer of all its assets to a new corporation formed, controlled and operated by Morris White (the stockholder owning the defendant corporation), without giving anything at all to the Morris White, Inc., without payment of a nickel to the creditors, with a salary of $60,000 to White (R., 114-5), with a priority of about $50,000 for fees and expenses for receiver and its counsel (R., 51, 101), and with a priority for an unnamed amount for the fee of counsel for the "friendly" creditors (R., 26). And all this in a case of a corporation with only $5,000 in the treasury (R., 134), with book liabilities of over $1,072,000 (R., 32), and with assets of only problematic value!

It is a fair, if not inevitable inference, that just such a disposition was contemplated when the complaint was filed by Mr. Glass, who immediately became counsel for the receiver. The complainant was evidently *provided* for the purposes of the suit (R., 57, 74, 75). She is a resident of New Jersey, and to her, shortly before commencement of the suit, one of the bank creditors (a member of the so-called Creditors' Committee) assigned a note of Morris White, Inc. No allegation is made that the assignment was for value (R., 4).

The White offer was presented to the court upon the petition of the receiver, through Mr. Glass, within three

weeks after the receiver's appointment (R., 16, 32, 57, 75). This petition took the friendliest tone toward the White offer and closed with this highly significant recommendation to the court (R., 18):

> "Ninth. That in your petitioner's opinion prompt action is desirable *in order to facilitate the prompt termination of this receivership.*"

To the petition of the receiver there were annexed the consent of the Creditors' Committee (R., 33), and a statement that the liabilities of the defendant corporation were $1,072,000.30 (R., 32). No inventory or other statement of the assets or their value was attached or ever furnished.

At the very time that the counsel for the receiver was presenting the White offer to the court, he was also continuing to act as counsel for the complainant (R., 7). Presumably, Mr. Hollander, who was chairman of the Creditors' Committee (R., 34), and who "represents one of the New Jersey banks" (R., 56), is the representative on that Committee of the complainant's assignor bank. Thus, it reasonably appears that the counsel for the receiver is, in his capacity as counsel for the dummy complainant, the designee of this same Creditors' Committee who engineered this friendly receivership, who were the proponents of the White offer, and as to whom Mr. Glass himself said (R., 52):

> "The Creditors' Committee is responsible for the promulgation of the reorganization plan."

The Record shows that Mr. Glass also continued throughout to act as counsel for the dummy complainant, whose claim on behalf of the New Jersey National Bank & Trust Company was in the District Court included among those favoring the plan (R., 4, 7, 56). Thus, at all times Mr. Glass was actively aligned with the creditors advocating the White offer.

Page 47 of the Record shows that Mr. Glass appeared in the District Court for both the complainant and the

receiver, and page 165 of the Record shows that Mr. Glass appeared in the Circuit Court of Appeals in the same capacities.

So also when this matter was before this Court on the petition for writ of certiorari, a brief was submitted by Mr. Glass and others in which he opposed the granting of the writ.

Throughout the argument in the District Court on the subject of the acceptance of the White offer, the attitude of Mr. Glass, while professing neutrality (R., 49), was actually one of favoring advocacy. (See, for example, pages 37, 44, 48-52, 100-2 of the Record.)

We therefore submit that not only was this equity receivership improvident and obviously so at the time the White offer was submitted, but also that the attitude and multifold relationships of the receiver's counsel made this a "friendly" receivership typifying all the grounds on which this Court has based its warnings against such a receivership in:

Harkin v. *Brundage*, 276 U. S. 36;
United States v. *Butterworth-Judson Corp.*, 269 U. S. 504;
Re: Metropolitan Ry. Receivership, 208 U. S. 90.

Apparently the rule of this court against "friendly" receiverships received no consideration on the part of respondents. The rule, however, is of great and growing importance for the protection of creditors and of contract obligations. This Court must "put teeth" into the rule in order to make it effective, since the court below has given no effect to it.

Other courts have given effect to the rule laid down in *Harkin* v. *Brundage, supra.* See, for example,

Central Union Trust Co. v. *North Butte Mining Co.*, 26 F. (2) 675;
Municipal Financial Corp. v. *Bankus Corp.*, 45 F. (2) 902, 905.

In the recent case of *May Hosiery Mills* v. *F. & W. Grand etc. Stores,* 59 F. (2) 218, the District Court in Montana did not hesitate to look through the form and into the real purpose of the receivership suit. The court said:

> "After due consideration, taking the pleadings by four corners, looking through forms to discover intent, assuming at least the perspicacity of the average man, ignoring conclusions, giving due weight to facts, having in mind the principles of pleading and equity and the federal statute (Judicial Code Sec. 37 (28 USCA Sec. 80)), it is clear that the proceedings are collusive, sham, fictitious, in bad faith, of ulterior motive, for the benefit of defendant alone; * * * that to accomplish the illegal ends sought, and as a party to the conspiracy, the aid of the court is solicited; that the latter's cooperation by injunction and receivership would be abuse of the power of the court though within it, in disregard of its right and duty, and perversion of process to the injury of creditors and others without notice and not before the court.
>
> "A court of equity should not thus work inequity and convert the temple of justice to a place of injustice. No doubt defendant owes plaintiff, but none the less the case-made, by reason of procedure, motive, strategy, and object, is sham, fictitious, collusive, an affront to equity, insolent, and an imposition upon the court. The suit is on all fours Hardy's Case, supra (20 F. (2) 968). Plaintiff is a dummy or mere 'tool' of defendant, and the proceedings are 'collusive', to adopt the characterization of Chief Justice Taft in the like and later Harkin Case, supra (276 U. S. 36). The only reasonable inference is that the prime object of this suit is receivership as final relief, and unwarranted injunction and moratorium at creditors' expense; is to hinder and delay and so to defraud and oppress creditors; is to enable defendant by its executive vice president receiver to work its will with creditors; is to rid itself of unprofitable leases and other contracts, by repudiation, compromise, settlement on his terms, and to the disadvantage of creditors coerced

by the delay and expense of receivership indefinite if not for life prolonged * * *.

"If the scheme be furthered by the co-operation of, say, an amiable court, what is it but employment of the judicial club to beat off and hold up creditors until, wearied, they settle with or wait the pleasure of the debtor's executive vice president receiver shielded by the judicial gown?" (p. 220). * * *

"Slight is the probability, however, that any protest or voice crying in the wilderness will inspire repentance, make straight the way, or save this jurisdiction surely marked for destruction. But come that fatal day as come it will, to the ghost of our murdered authority which will not down, but rise to reproach us, this court, with a clear conscience, can protest, 'Thou canst not say I did it'." (p. 221).

The court not only denied the application for an ancillary receiver, but issued a rule to show cause to parties and *counsel* why they should not be punished for contempt. The court adjudged them in contempt and imposed a fine of $500!

The simplest way of making the rule against "friendly" receiverships effective is to let those bear the costs of such receiverships, who bring them about. Had Morris White and his friendly complainant not been under the impression that they could make the creditors pay the administration costs of this receivership, which for the first seven weeks were $50,000 (R., 51), they would have thought twice before imposing such proceedings on the court and on the petitioners.

There is ample precedent for the proposition that where a receivership is irregular, the costs should be borne by those who bring it about.

Fryer v. *Weakley*, 261 Fed. 509, 514,
Noxon Chemical Products Co. v. *Leckie*, 39 F. (2d) 318,

where it was held that the court had no jurisdiction to appoint a general receiver.

Hawes v. *First Nat'l Bank*, 229 Fed. 51, 59,

where there was failure to join an indispensable party.

Spencer v. *Taylor Creek Ditch Co.*, 194 Fed. 635, 643,

where the receiver rendered no actual service to the property.

See also

Ephraim v. *Pacific Bank*, 129 Cal. 589, 62 Pac. 177,

cited with approval in

Atlantic Trust Co. v. *Chapman*, 208 U. S. 360, 373,
High on Receivers (4th Edition) Sec. 796,
Beach on Receivers (2nd Edition) Sec. 774.

The same rule should apply to payment of receivership costs in an improper "friendly" receivership.

II.

In any event, the receiver's counsel fees should not be in whole or in part any charge, directly or indirectly, against these petitioners.

Petitioners should not be required to pay, directly or indirectly, any part of the fees of the attorneys and counsel for the receiver, who were also attorneys and counsel for the complainant and whose attitude and dual relationships have been already described.

The attorneys and counsel for the complainant should not have been appointed to act for the receiver, or, at least, should not have been permitted to continue for the receiver while at the same time continuing as attorneys and counsel for the complainant and for the partisan interests behind her and for which she was a dummy. In *Blair* v. *St. Louis, H. & K. Railroad Company*, 20 Fed. 348, the receiver applied for appointment of counsel and named the counsel for the plaintiff. The court refused to appoint the counsel for the plaintiff. It said (p. 349):

> "It is urged that the attorney for the plaintiff should be authorized to act for the Receiver, in as much as the plaintiff is especially interested in defeating all claims adverse to plaintiff's rights, and securing an economical administration of the estate. *To this it must be answered that he represents his own client, and the latter can employ him and pay him accordingly if desired, but cannot fasten his compensation on a fund in which he has not the sole interest, but often only a partial or adverse interest.* His appointment might be wholly inconsistent with his duties as plaintiff's counsel."

In a case where the district court had appointed a counsel for one of the creditors to act as counsel for the receiver, and, after the counsel had acted under the appointment, compensation was allowed by the district court, the Circuit Court of Appeals reversed the order and held that the counsel was not entitled to compensation.

> *Old Colony Trust Co. et al.* v. *Union Land and Cattle Co.*, 4 F. (2d) 449;

See also

> *High on Receivers* (4th Edition) Secs. 188 and 216.

The latest expression of this court on the right of attorneys to represent adverse interests is contained in the case of *Weil* v. *Neary*, 278 U. S. 160. Chief Justice Taft, delivering the opinion of the court, said (p. 168):

> "*Many abuses have occurred in the bankruptcy practice and none is more frequent than that by which the attorney for petitioning creditors becomes counsel for the trustees subsequently appointed. This mingling of interests, frequently conflicting, is generally regarded by courts as working to the detriment of one of the parties and to the undue advantage of another.* Experience has shown the wisdom and necessity of separating the function and obligation of counsel by forbidding the employment in different interests of the same person."

The Record discloses, as above set forth, that this equity receivership was a mere incident to the plans of the so-called Creditors' Committee and was engineered by that Committee. The charges of all counsel who continued to represent those interests should be borne by those interests themselves.

To throw even an aliquot portion thereof upon these petitioners, who have been obliged strenuously to fight those interests to secure the petitioners' rights, would, we submit, be not only illegal but grossly unfair and immoral.

CONCLUSION.

Petitioners therefore pray that the decree of the Circuit Court of Appeals be reversed and the cause remanded to the District Court with the following directions: (1) that the so-called "reorganization plan" be held not to affect the claims of the petitioners herein against Morris White, Inc.; (2) that petitioners herein be permitted to prove and recover their claims against Morris White, Inc., and its assets and the proceeds thereof wherever found, save when in the hands of a *bona fide* purchaser for value and without notice; (3) that the property of Morris White, Inc., whether in the hands of the receiver or in the hands of the Trustee in Bankruptcy of the Morris White Handbags Corporation, be subject to payment of those debts before any costs or obligations of the Receiver of Morris White, Inc. or of the Trustee in Bankruptcy of the Morris White Handbags Corporation and before any claims against the Morris White Handbags Corporation are paid; (4) that if the assets in the hands of the Receiver herein and in the hands of the Trustee in Bankruptcy of the Morris White Handbags Corporation are insufficient to pay the claims of the petitioners herein, petitioners herein should be paid in proportion to their claims and should be entitled to all their rights as if the case had proceeded in bankruptcy as of April 6, 1931.

Dated, New York, November 14th, 1932.

Respectfully submitted,

CHARLES H. TUTTLE,
of New York,

GREGORY HANKIN,
of Washington,

SAUL S. MYERS,
of New York,

Counsel for Petitioners.

Appendix.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

VALERIA E. CORIELL, Complainant, *against* MORRIS WHITE, INC., Defendant.	IN EQUITY No. E 59-126

ORDER ON MANDATE.

This cause having heretofore come on for hearing in the United States District Court for the Southern District of New York, and a decree, dated June 15, 1931, having been entered herein approving the offer of Lily White herein, and National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein and G. Levor & Co. Inc., having thereafter by an appeal procured a transcript of the record to be brought into the United States Circuit Court of Appeals for the Second Circuit, and the said United States Circuit Court of Appeals for the Second Circuit having transmitted to this Court its mandate dated December 2, 1931, by which it appears that at the October Term of said Court for 1931 the said cause came on to be heard before the said United States Circuit Court of Appeals for the Second Circuit on the said transcript of record and was argued by counsel, on consideration whereof it was ordered, adjudged and decreed that the said order of said District Court be reversed with costs taxed at the sum of $1,175.30, and the cause be remanded to the District Court

for further proceedings in accordance with the opinion of said Circuit Court of Appeals for the Second Circuit;

Now, upon reading and filing the said mandate, it is

ORDERED, ADJUDGED AND DECREED that the said mandate of said United States Circuit Court of Appeals for the Second Circuit in this cause be and the same hereby is made the judgment of this court; and it is further

ORDERED, ADJUDGED AND DECREED that the said decree of this court dated June 15, 1931 approving the offer of Lily White, in so far as it affects the rights of National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein and G. Levor & Co., Inc., the appellants herein, be and the same is hereby reversed, with costs of the said appeal as taxed at the sum of $1,175.30, together with the costs in this court, taxed at ; and it is further

ORDERED, ADJUDGED AND DECREED that National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein and G. Levor & Co., Inc., have judgment against Irving Trust Company, as Receiver in Equity of Morris White, Inc. for the sum of $ costs on appeal as taxed and costs in this court, and that Irving Trust Company, as Receiver in Equity of Morris White, Inc. be and it hereby is directed to pay said costs out of moneys in its possession as such Receiver in Equity; and it is further

ORDERED, ADJUDGED AND DECREED that Earl B. Barnes of New York City, Borough of Manhattan, City of New York, be and he hereby is appointed Special Master herein to hear and take testimony and other evidence and to report thereon to this court, in conformity with the aforesaid opinion of said United States Circuit Court of Appeals; and it is further

ORDERED, ADJUDGED AND DECREED that the said Special Master shall proceed with said hearings and report thereon

with all convenient speed and as rapidly as he deems it proper, in view of all the circumstances of the case; and it is further

ORDERED, ADJUDGED AND DECREED that the said Special Master shall ascertain the several amounts of the respective claims of National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein and G. Levor & Co., Inc. and make an appraisal of the realizable value of said claims as of June 15, 1931; and it is further

ORDERED, ADJUDGED AND DECREED that the said Special Master shall take an account of the assets of Morris White, Inc. as of the 15th day of June, 1931, including among such assets all causes of action belonging to Morris White, Inc. and shall ascertain and report the then realizable value of said assets as if sold at a public sale; and shall also take account of the liabilities of Morris White, Inc., as of April 6, 1931, and shall ascertain and report which if any, of said liabilities are entitled to priority of payment; and shall also take an account of the obligations of the Receiver herein and of the expenses of administration of the estate herein incurred up to the fifteenth day of June, 1931; and shall determine through examination of officers and/or agents of the defendant and/or The Morris White Handbags Corporation, the nature, quality and amount of inventory on hand as of such dates as may be pertinent to this inquiry; and it is further

ORDERED, ADJUDGED AND DECREED that the said Special Master shall conduct hearings and take testimony and other evidence and report as to whether or not preferences or transfers, voidable either at law or in equity, as of June 15, 1931, at the instance of any creditor or other party interested in the assets of the Morris White, Inc., have been granted by the pledging of any assets of Morris White, Inc. or otherwise; and at the hearings before the said Special Master any creditor of Morris White, Inc. shall have the opportunity of questioning the assignment of ac-

counts by it as collateral and of questioning any such voidable preference or transfer that may have been made; and it is further

ORDERED, ADJUDGED AND DECREED that if it is established that any such voidable preferences or transfers have been granted or made out of the assets of Morris White, Inc., said preferences or transfers are to be regarded by said Special Master as invalid for the purposes of his calculations and the amounts of said preferences or transfers are to be considered by said Special Master as part of the assets of said Morris White, Inc.; and it is further

ORDERED, ADJUDGED AND DECREED that the said Special Master shall ascertain and report the aliquot share of the assets to be awarded and paid in cash, subject to further order of this court, to National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein, and G. Levor & Co., Inc. out of the sum ascertained to be the amount that would have been realized for the assets of Morris White, Inc., on June 15, 1931, had a public sale of said assets been held, after the deduction from said sum of such portion of the obligations of the Receiver and the expenses of adminstration herein as would have been properly chargeable against the estate had the assets of Morris White, Inc. been liquidated by sale, and the proceeds distributed to creditors in ordinary course, and after the deduction of the liabilities of Morris White, Inc. entitled to priority of payment; or at the option of each of them the preferred stock and notes heretofore offered to them, pursuant to said offer of Lily White, may and shall in like manner be valued by said Special Master, as of the date the reorganization plan became effective, to be awarded and to be paid in cash to them or any of them subject to the further order of this court; and it is further

ORDERED ADJUDGED AND DECREED that no bank or other creditor of Morris White, Inc. shall collect on any security which has been pledged as collateral and in addition thereto

receive preferred stock and notes but that each bank or other creditor holding any security may agree to receive and shall receive preferred stock and notes only for such sum or sums as their respective claims exceed the realizable value of said collateral; and the said Special Master shall ascertain and report the value of the security, held by secured creditors, for all purposes, as of June 15, 1931; and it is further

ORDERED, ADJUDGED AND DECREED that the expense of the hearings before the said Special Master, including his compensation and the cost of a copy of the minutes of the Special Master shall be paid by The Morris White Handbags Corp. and shall be a charge and a lien upon its property; and it is further

ORDERED, ADJUDGED AND DECREED that the said Special Master shall give notice to all the parties hereto of the filing of his report and thereafter any of the parties may apply to this court for such further order thereon as they may be advised; and it is further

ORDERED, ADJUDGED AND DECREED that subject to the provisions of this order and the further order of this court, the reorganization plan represented by the aforesaid offer of Lily White, as modified by this order and by the order entered herein, dated June 15, 1931, be allowed to continue in operation and The Morris White Handbags Corp. be and it hereby is permitted to continue in the conduct of the business heretofore transferred to it pursuant to the terms of the aforesaid order, dated June 15, 1931; and it is further

ORDERED, ADJUDGED AND DECREED that all persons, firms or corporations which have heretofore sold and delivered goods, wares and merchandise and/or rendered services to the said The Morris White Handbags Corp. in the regular course of its business and/or which may hereafter sell and deliver goods, wares and merchandise and/or render services to the said The Morris White Handbags Corp. in the regular course of its business shall be entitled to priority

of payment out of the assets of The Morris White Handbags Corp., other than such assets as were transferred to the said The Morris White Handbags Corp., pursuant to said order dated June 15, 1931, for any such indebtedness now or hereafter owing by the said The Morris White Handbags Corp. to any such persons, firms or corporations; and it is further

ORDERED, ADJUDGED AND DECREED that A. W. COPP, or such other representative as Irving Trust Company may appoint in place of said A. W. Copp, shall, at the expense of The Morris White Handbags Corp., attend daily, if possible, at the place of business of The Morris White Handbags Corp., and said The Morris White Handbags Corp. shall render to the said A. W. Copp full and complete reports, as and when requested by him, of all details of its business and affairs as the same are carried on, including therein any and all information with respect to purchases, sales, payments, receipts, salaries, rents, expenses, contracts, commitments, and any other matters or things which may in any way affect the assets or liabilities of the said The Morris White Handbags Corp., that the said The Morris White Handbags Corp. shall give to the said A. W. Copp, or any representative named in his place, any information whatever appertaining to its affairs which the said A. W. Copp, or any representative named in his place, may request; that the said A. W. Copp, or any representative named in his place, shall report to the attorneys for the National Surety Co., from time to time as requested by them; and that Irving Trust Company shall not be under any liability whatsoever as Receiver in Equity of the defendant or otherwise for the management of the business of The Morris White Handbags Corp., or the performance by A. W. Copp, or the representative named in his place, of the duties imposed upon him by this order; and it is further

ORDERED, ADJUDGED AND DECREED that pending the entry of an order of this court upon the report of the said Special

Master and for the purpose of securing to National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein and G. Levor & Co. Inc. payment by the said The Morris White Handbags Corp., out of the assets transferred to the said The Morris White Handbags Corp., pursuant to the order herein dated June 15, 1931, of the amounts which may be determined to be paid to them in cash upon their respective claims, a lien is hereby imposed upon all of the assets of Morris White, Inc. transferred to and remaining in the possession of said The Morris White Handbags Corp., pursuant to said order dated June 15, 1931; except that as to such of said assets as the said The Morris White Handbags Corp. shall hereafter in good faith transfer in the regular course of its business for fair and proper consideration, said lien shall attach to the proceeds of such transfers or successive transfers of such proceeds, and the said The Morris White Handbags Corp. is hereby enjoined and restrained, subject to the further order of this court, from transferring any of said assets of Morris White, Inc. remaining in its possession except in good faith in the regular course of its business and for fair and proper consideration, unless the said The Morris White Handbags Corp. shall file a bond or other security in such amount as may be fixed and approved by this court after hearing the parties in interest; and it is further

ORDERED, ADJUDGED AND DECREED that the Morris White Handbags Corporation having paid to Irving Trust Company herein the sum of $33,322.32, represented by it to be the amount payable by it on January 2, 1932 on account of the notes issued pursuant to the terms of the sale approved in the said decree on June 15, 1931, such payment shall not, without further order of the Court, be applied on account of said notes but shall be held by Irving Trust Company as depositary, without prejudice to any of the rights of the parties to this proceeding; and it is further

ORDERED, ADJUDGED AND DECREED that all question not hereby disposed of are reserved for future adjudication; and that for the purpose of enforcing the provisions of this decree and for the purpose of entering such further orders or decrees as the court may hereafter from time to time determine, the term of this court is hereby extended and jurisdiction of the cause is hereby retained. This order is without prejudice to the motion heretofore made by the Equitable Life Assurance Society to set aside the aforesaid order of June 15, 1931, and without prejudice to such right as it may assert within thirty days after the filing of the report of the Special Master and the entry of an order thereon, to have its aliquot share of the assets of Morris White, Inc., paid to it in cash in accordance with the procedure hereby established, and to have a lien as above provided for the payment of such share.

Dated February 2nd, 1932.

JNO. C. KNOX,
U. S. D. J.